

**STATE OF CALIFORNIA  
DEPARTMENT OF INSURANCE  
45 Fremont Street, 24th Floor  
San Francisco, California 94105**

**INITIAL STATEMENT OF REASONS**

**Date: June 17, 2008**

**REG-2008-00021**

**TITLE INSURANCE – CONTROLLED BUSINESS SOURCE**

**INTRODUCTION**

In 1989, the California legislature enacted article 4.5 of Chapter 1 Title Insurance, Part 6, Division 2 of the Insurance Code (Insurance Code sections 12396, 12397, 12397.5, 12398 and 12399) entitled “Business Plans” and commonly known as the “Controlled Business Source statute.” The California Controlled Business Source statute followed former Insurance Commissioner Robert C. Quinn’s bulletin number 81-8 dated December 30, 1981 on the subject of controlled business in the title insurance industry. Since enactment of California’s Controlled Business Source statute, there have been other regulatory developments such as the issuance by the U.S. Department of Housing and Urban Development (“HUD”) under the federal Real Estate Settlement Procedures Act of 1974 (“RESPA”) 12 U.S.C.A. §§ 2601 *et seq.* of its Statement of Policy 1996-2, as well as changes to federal law that permit title insurance sales activities by national banks and their subsidiaries in states where such activities are permitted under existing state law grandfathered under the federal Gramm-Leach-Bliley Act of 1999 (“GLBA”) 15 U.S.C.A. § 6713. In the past several years there has been a significant increase in the number of title entity controlled business source arrangements operating in the state of California.

Title entity controlled business arrangements, also known as affiliated business arrangements, are business activities that require special regulation in order to maintain a competitive title insurance marketplace. Title insurance, unlike other forms of insurance, is usually purchased in conjunction with a larger transaction, namely the sale or refinancing of real property. As the purchase of title insurance is a much smaller transaction in relation to the purchase or refinancing of real property, typically a title insurance policy and related escrow services will be purchased without any comparison shopping by the purchaser. Often purchasers of title insurance related services follow the recommendations of interested persons such as their realtor or lender when choosing a title licensee. Sometimes the interested persons recommend customers purchase title policies and escrow services from title businesses in which they own a controlling interest. These controlled business sources are realtors, lenders and other related businesses that own a significant interest in a title licensee to whom they may refer business. Although federal law requires the disclosure of these affiliated business relationships at the time of purchase of the underlying property, California law more stringently and protectively provides for title entities with controlled business sources to compete for non-controlled business, to intend to generate no more than fifty percent of its closed title orders from controlled business sources, to maintain records of source of title business and to report annually such percentages to

the Department of Insurance. Moreover related California law provides that information disseminated to the California public regarding persons involved in the insurance business, may not be misleading.

The Commissioner believes these proposed regulations are necessary to carry out the purpose of the Controlled Business Source statute, namely to promote the regulation of the business of title insurance emanating from controlled business sources, also known as affiliated business arrangements, so that competition in the title industry is enhanced. Further the proposed regulations will clarify expectations for compliance by title insurers and underwritten title companies with the Controlled Business Source statute and related provisions of the Insurance Code. The proposed regulations are reasonably necessary to achieve regulatory compliance in this area. These proposed regulations are a comprehensive set that are proposed to address each of the sections of the Controlled Business Source statute, as well as related statutes.

### **SPECIFIC PURPOSE AND REASONABLE NECESSITY OF EACH REGULATION**

The specific purpose of each adoption and the rationale for the Commissioner's determination that each adoption is reasonably necessary to carry out the purpose for which it is proposed are set forth below.

Proposal to adopt a new Section 2555 entitled "Authority and Effective Date."

New regulatory section 2555 sets forth the authority that the proposed regulations are promulgated and provides the regulations shall be effective on January 1, 2009. The Controlled Business Source statute and related statutes require title insurers and underwritten title companies to maintain certain business records for examination by and production to the Department of Insurance and annual reporting of certain information to the Department of Insurance. The Controlled Business Source statute also requires certain indications at the time of application for license or permit. This section is reasonably necessary to establish an effective date for the record keeping, reporting and indications as specified in these new regulations. These regulations will in addition require that controlled business source arrangements be disclosed in advertising and websites of title licensees. As the regulations clarify and make specific the Controlled Business Source statute and related statutes, this section is reasonably necessary to reflect which sections of the Insurance Code authorize these regulations and which Insurance Code sections are being implemented and made specific by these regulations and provide a date for compliance. Further these regulations contain a number of enforcement mechanisms for enforcing compliance with the Controlled Business Source statute, related statutes and these regulations. It is reasonably necessary to specify which Insurance Code sections together with these regulations are subject to these expressed enforcement mechanisms.

Proposal to adopt a new Section 2555.1 entitled "Purpose."

This new regulatory section explains that the purpose of these regulations is to set forth the rules and procedures necessary to promote the regulation of the business of title insurance emanating from controlled business sources so that competition in the title industry is enhanced,

expectations for compliance by title insurers and underwritten title companies are clarified, and regulatory enforcement efforts are streamlined. Not all title entities have controlled business sources. It is reasonably necessary to clarify the purpose of these regulations so that all title insurance licensees will be apprised that these regulations address all title entities, particularly those with controlled business sources, and the requirement that all title insurers and underwritten title companies maintain records and report source information in relation to business source. Further it is reasonably necessary to establish that the purpose of these regulations is to enhance competition in the title insurance marketplace by requiring competitive indications and behavior, especially given the unique competition for business that prevails in the title insurance marketplace.

Proposal to adopt a new Section 2555.12 entitled “Definitions.”

New regulatory section 2555.12 defines a number of terms as reasonably necessary for the implementation and enforcement of the Controlled Business Source statute and these regulations. The proposed regulation section defines certain terms as is reasonably necessary to clarify and state their meaning to facilitate understanding and compliance with the Controlled Business Source statute by title licensees. The proposed regulatory section defines the terms “Affiliate,” “Binder,” “Commitment,” “Closed Title Order,” “Control” including the terms “controlling” “controlled by” and “under common control with,” “Controlled Business Source,” “Documented,” “License,” “Licensee,” “Non controlled business source,” “Percentage,” “Preliminary Report,” “Source,” “Title business,” and “Title business transacted.”

The Controlled Business Source statute includes certain terms such as “closed title order” which are not defined in the statute. An express definition of these terms in the proposed section will facilitate compliance with the statute and will facilitate comparisons of reports, records and other information received by the Department of Insurance and its enforcement of the statute. The Controlled Business Source statute defines certain terms by cross reference to other Insurance Code sections, such as the term “controlled business source,” which cross referencing may lead to confusion amongst title licensees as to the meaning of the term. An express definition of these terms in the proposed section will facilitate compliance with the statute and will facilitate comparisons of reports, records and other information received by the Department of Insurance and its enforcement of the statute. Two terms, “license” and “licensee” are defined in the Controlled Business Source statute by inclusion of terms such as “title insurance entity” that are not defined. The new section will clarify these terms, for example what title insurance entities are licensees for purposes of the Controlled Business Source statute and these regulations. This new section will also as reasonably necessary define terms that are included within definitions. An express definition of these terms in the proposed section will facilitate compliance with the statute and will facilitate comparisons of reports, records and other information received by the Department of Insurance and its enforcement of the statute.

In addition this new section will implement the provision of the Controlled Business Source statute that provides for the deemed emanation of business from controlled business sources in a manner that is reasonably necessary and consistent with the Controlled Business Source statute’s

requirements for record keeping of source data.

Proposal to adopt a new Section 2555.13 entitled “Applications for license.”

New regulatory section 2555.13 provides the requirements for indications of the intent to actively compete at the time of application. The new section clarifies what is meant by marketplace for underwritten title company applicants and title insurance company applicants and sets forth other requirements. The new section clarifies the manner in which intent shall be established in the application. The new section further clarifies that failure to so establish an intent to actively compete at the time of application shall be grounds for denial of the application for license.

New regulatory section 2555.13 also provides the requirements for indications of intent to limit controlled source business at the time of application to no more than fifty percent (50%) of their closed title orders. The new regulatory section includes certain of the terms defined in new section 2555.12 such as “closed title order.” The new section further clarifies that failure to so establish an intent to actively compete at the time of application for license shall be grounds for denial of the application for license. It is reasonably necessary to promulgate this new regulatory section to facilitate compliance and to uniformly implement and enforce the intent to compete and limit controlled business source business provisions of the Controlled Business Source statute.

Proposal to adopt a new Section 2555.2 entitled “Annual Verified Reports.”

New section 2555.2 makes specific the reporting requirements for the ninety day annual report by all title licensees and the thirty day report made thereafter by title insurers. It is reasonably necessary to clarify filing requirements such submission address, as the Department of Insurance has more than one office location. It is also reasonably necessary to provide the month and calendar date by which reports must be so filed, to facilitate compliance and enforcement of the Controlled Business Source statute. The new section also specifies requirements for verification by chief executive officers or their designees. Further the new section clarifies that reports of underwritten title company licensees shall be simultaneously transmitted to their underwriters to implement the statutory provisions pertaining to underwriter’s thirty day reports. It is reasonably necessary to promulgate this regulatory section in order to implement and enforce the annual reporting requirements.

Proposal to adopt a new Section 2555.21 regarding contents of the March 31<sup>st</sup> reports.

The new section 2555.21 clarifies and specifies what underwritten title company and title insurer underwriters need to report to the Department of Insurance. Reference is made in the new section to terms defined in new section 2555.12 such as “controlled business source.” The expression of what is required in the content of these reports in the new regulatory section, together with the quality and character of the verifications as set forth in the preceding proposed section, will facilitate compliance with the statute and will facilitate comparisons of reports, records and other information received by the Department of Insurance and its enforcement of

the statute. It is reasonably necessary to promulgate this regulatory section in order to implement and enforce the statutory annual reporting requirements.

Proposal to adopt a new Section 2555.22 regarding contents of the April 29<sup>th</sup> reports.

The new section 2555.22 clarifies and specifies what underwriters need to report to the Department of Insurance upon review of underwritten title company reports. This new section further provides that title insurers that can not confirm underwritten title company report, shall provide the correct information or the identity and location of individuals and information such that the Commissioner may as warranted conduct further examination. It is reasonably necessary to require reference to individuals, documents and data as may be necessary for verification by regulatory examination in order to fully implement the Controlled Business Source statute. The expression of what is required in the content of these reports in the new regulatory section, together with the quality and character of the verifications as set forth in the proposed section 2555.2, will facilitate compliance with the statute and will facilitate comparisons of reports, records and other information received by the Department of Insurance and its enforcement of the statute. It is reasonably necessary to promulgate this regulatory section in order to implement and enforce the statutory annual reporting requirements.

Proposal to adopt a new section 2555.23 regarding suspension of the March 31<sup>st</sup> reporting requirement.

The Controlled Business Source statute provides for a suspension of annual reporting requirements if controlled business sources generate less than five percent of a title licensee's business. New regulatory section 2555.23 provides that any March 31st report filed after the effective date of the regulations which reports five percent or less of all its title business transacted emanated from controlled business sources and identifies individuals and documents for examination will be relieved of further reporting under this subarticle until such time as business emanating from controlled business sources exceeds five percent, at which time the obligation to report will resume. It is necessary and reasonable to include this new regulatory section which provides for the suspension of the March 31 reporting requirement to implement the Controlled Business Source statute. Further, it is reasonably necessary to require reference to individuals, documents and data as may be necessary for verification by regulatory examination of the five percent or less report.

Proposal to adopt a new section 2555.3 entitled "Maintenance of Records."

The Controlled Business Source statute requires maintenance of certain records sufficient to indicate the source of title orders, but does not specify the length of time such records need be maintained, nor the quality and certain specific content of the records to be so maintained. The proposed new regulatory section 2555.3 will clarify that each title licensee shall maintain records for a minimum of seven years. In addition the new section will clarify that documents need be maintained as are sufficient to document the source of title business transacted by complete name and address of the source, any commission or other consideration paid to the source, and

whether or not the source is a controlled business. Further the new section will require maintenance of total dollars or income information from each transaction and the total of all income earned for each quarter of the calendar year. The new section will also require maintenance of the same transaction records for the same seven year time period as to closed title orders, however such records shall include a count of each closed title order by licensee, and the total number of closed title orders for each calendar year quarter rather than total dollars or income. It is reasonably necessary to adopt this proposed new section so that the documents and data maintained by the title licensee is sufficient as may be necessary to verify by regulatory examination compliance with the Controlled Business Source statute and to measure competitive behavior.

Proposal to adopt a new section 2555.31 entitled “Submission of Records.”

The Controlled Business Source statute provides for submissions as are required by the Department of Insurance but does not specify the manner in which such submissions may be requested and submitted. The new regulatory section proposed for adoption will clarify that requests for submission to the Department of Insurance shall be in writing, and submissions shall be completed within twenty days of receipt thereof, or in such other time period as is reasonable under the circumstances and acceptable to the Commissioner. The new section will also specify that the submissions are the records or reports maintained pursuant to these regulations and the Controlled Business Source statute. It is reasonably necessary to adopt this new regulatory section to implement and make specific the requirements for submissions to the regulator. Written requests with a twenty day response requirement, modifiable by the Commissioner as reasonable under the circumstances, is reasonably necessary for the implementation and enforcement of the Controlled Business Source statute and to measure competitive behavior.

Proposal to adopt a new section 2555.32 entitled “Disclosure of Controlled Business Source Arrangements.”

Disclosure of controlled business source arrangements in publicly disseminated information will provide title customers with additional information upon which to make an informed title insurance service purchasing decision. This new regulatory section will clarify that each licensee shall disclose its controlled business source arrangements in all information generally disseminated to the public in this state, including its internet website and any newspapers or other publications or devices by which the licensee advertises. It is reasonably necessary to adopt this regulatory section so that purchasers of title insurance services are not misled as to the nature of the services they are purchasing. This new regulatory section should enhance competition in the title insurance marketplace.

Proposal to adopt a new section 2555.33 entitled “Examinations.”

This new section will provide that the Commissioner may, as often as may be reasonable and necessary to determine a licensee’s compliance with the standards of these regulations the Controlled Business Source statute and other Insurance Code provisions, examine each licensee.

This new section will provide that such examination of a licensee may include a review of the records maintained by each licensee to ascertain the source of title business and the source of closed title orders. It is reasonably necessary to include a section that provides for examinations of the records maintained in order to implement the Controlled Business Source statute provisions. It is reasonably necessary to clarify that examination is one of the regulatory mechanisms that the Commissioner may use to verify compliance with the Controlled Business Source statute provisions.

Proposal to adopt a new section 2555.4 entitled “Enforcement.”

This new regulatory section will set forth the enforcement options the Commissioner may utilize for failure of a title licensee to comply with any of the requirements of these regulations. Specifically this new section will specify enforcement through denial of the application for title license or securities permit, suspension, restriction or revocation in whole or in part of an issued license or permit, an order to cease and desist, an increase in statutory deposits and monetary penalties. It is reasonably necessary to set forth in this new section all of the disciplinary penalties the Commissioner may undertake against a licensee for violations of these regulations and the Controlled Business Source statute and the procedures therefore to enhance regulatory compliance by the industry and streamline enforcement actions as may be taken by the Commissioner.

Proposal to adopt a new section 2555.41 entitled “Separability.”

This new section simply provides that if any provision of these regulations or the application thereof is determined to be invalid, the invalidity shall not affect the other provisions or applications of these regulations which are separable. This new section is similar to provisions in other promulgated regulations that consist of multiple related sections. It is reasonably necessary to adopt this new section given the number of sections included in these regulations.

## **IDENTIFICATION OF STUDIES AND OTHER INFORMATION**

The Commissioner has identified the following studies, reports, testimony, and other documents relied upon in proposing the adoption of these regulations:

1. Title Insurance Actions Needed to Improve Oversight of the Title Industry and Better Protect Consumers United States Government Accountability Office (GAO) Report to the Ranking Member , Committee on Financial Services, House of Representatives April, 2007;
2. Title Insurance Preliminary Views and Issues for Further Study, Statement of Orice M. Williams, Director Markets and Community Investment, United States Government Accountability Office (GAO) Testimony Before the Subcommittee on Housing and Community Opportunity, Committee on Financial Services, House of Representatives, April 26, 2006;

3. Title Insurance Preliminary Views and Issues for Further Study, United States Government Accountability Office (GAO) Report to the Chairman, Committee on Financial Services, House of Representatives, April, 2006;
4. Report to the California Insurance Commissioner, An Analysis of Competition in the California Title Insurance and Escrow Industry Birny Birnbaum, Consulting Economist, December, 2005;
5. Testimony of Douglas R. Miller, President and CEO Title One, Inc., Minneapolis, Minnesota Before the Subcommittee on Housing and Community Opportunity, Committee on Financial Services, House of Representatives, April 26, 2006;
6. Settlement Agreement entered into by and between the U.S. Department of Housing and Urban Development (“HUD”) the Florida Department of Financial Services (“DFS”) the Florida Office of Insurance Regulation (“OIR”) and The First American Title Insurance Company executed 9/21/07 through 11/15/07;
7. Settlement Agreement entered into by and between the U.S. Department of Housing and Urban Development (“HUD”) and The First American Title Insurance Company d.b.a. Memphis Title Company executed 7/1/05 through 7/8/05;
8. Colorado Real Estate Manual Chapter 23, Affiliated Business Arrangements;
9. Memorandum to Title Insurance Industry from Harry E. Stirmell, Supervisor, Title Insurance Section dated February 26, 2008 regarding Controlled Business – Title Agent Requirements;
10. 2006 UTC Income Statement Report Type of Income and Expense Ratio Analysis prepared by the California Department of Insurance rate Specialist Unit;
11. Insurance Organizations Authorized in California 2006 publication of the California Department of Insurance; and
12. 2007 California Licensed Title Insurers 5 Year Profitability Analysis – Aggregate prepared by the California Department of Insurance rate Specialist Unit.

## **SPECIFIC TECHNOLOGIES OR EQUIPMENT**

Adoption of these regulations would not mandate the use of specific technologies or equipment.

## **ALTERNATIVES**

The Commissioner has determined that no reasonable alternative exists to carry out the purposes for which these regulations are proposed.

## **ECONOMIC IMPACT ON SMALL BUSINESS**

The Commissioner has identified no reasonable alternatives to the presently proposed regulations, nor have any such alternatives otherwise been identified and brought to the attention of the Department, that would lessen any impact on small business.



## **PRENOTICE DISCUSSIONS**

The Commissioner has not conducted prenotice public discussions pursuant to Government Code Section 11346.45, because given the number of years the Controlled Business Source statute and its predecessor bulletin 81-8 have been available, and given the interest in the past several years in the subject of controlled business source/affiliated business arrangements, the many affected parties who would have been invited to participate in such discussions — primarily title insurers and underwritten title companies — are unlikely to find the proposed regulations too complex or multifaceted to be reviewed easily during the comment period.